Dissenting Views on H.R. 2896
American Jobs Creation Act of 2003
October 28, 2003

There are many issues that deeply divide the two parties in Congress. Issues like privatization of Medicare and Social Security, unemployment benefits, health insurance for the uninsured, funding of education programs, and fiscally irresponsible tax cuts define the differences between the two parties. We welcome an energetic, partisan dispute on those issues.

However, we do not believe that the issue of how to respond to the European challenge to our export-related tax benefits, called Foreign Sales Corporations/Extra-Territorial Income (FSC/ETI), should be the subject of a partisan dispute. There should not be a Democratic or Republican response to a challenge from our foreign competitors. There should be an American position to respond to the European position.

This is not the first time that our export-related tax benefits have been subject to a challenge by our foreign competitors. In the past, such challenges were met with a bipartisan, unified American response. We did not show our divisions, nor did Americans share legal briefs, with our opponents.

Unfortunately, there was a unilateral choice made last year to use this issue to enact an unrelated, partisan agenda. That agenda involved a long list of liberalizations to the tax rules that apply to the overseas operations of our multinationals. Essentially, the choice last year was to increase taxes on domestic manufacturers (through repeal of FSC/ETI) and use the money to subsidize offshore operations of U.S. multinationals.

As a country, we have paid a heavy price for that unilateral decision. It has delayed our response to the World Trade Organization (WTO) ruling by over a year, creating the potential for imposition of trade sanctions on our exports. During that one-year period, there has been an unrelenting attack on the substance of many of the provisions that have now been included in the Committee bill. Those attacks, in effect, have shared legal briefs and arguments that our European competitors now can use to challenge the U.S. response.

It need not have been handled that way. Congressmen Crane, Rangel, Manzullo and Levin introduced legislation (H.R. 1769) which demonstrates that a bipartisan, unified American response to the WTO challenge is possible. That legislation has approximately 150 cosponsors, equally divided between parties.

We had been hopeful that we could at least support the domestic manufacturing part of the Chairman's bill. Unfortunately, the Chairman decided not to include the substance of H.R. 1769. Instead, he included a deeply flawed provision that provides special interest benefits to large architectural and engineering companies like Bechtel and Halliburton.

Even if the Committee bill had included H.R. 1769, we could not support it because it includes many other provisions unrelated to the FSC/ETI issues. It is another fiscally irresponsible tax cut that threatens U.S. jobs. It is a bill that is dead on arrival in the Senate, creating the possibility of an impasse that could result in trade sanctions. It continues to use this trade dispute to enact an unrelated agenda, an agenda that threatens U.S. jobs. Following is an elaboration of our reasons for opposition.

1. Budget Impact

The Committee bill is another in a series of reckless tax bills that have resulted in unprecedented deficits. The Committee bill is estimated to add at least another $60 billion to projected Federal deficits over the next 10 years. However, the real cost of the bill will be far larger. The Committee bill resorts to long phase-ins, delayed effective dates, and temporary provisions to reduce its official score.

The tricks that have been used to hide the true cost of the bill are evident when one reviews the Joint Committee on Taxation revenue table that estimates a revenue loss of almost $12 billion in fiscal year 2013, a loss that is growing year-by-year. More than half of the revenue losses would occur in the last three years of the 10 year budget window. In addition, outyear costs will be even higher because some of the offsets in the bill are slated to expire at the end of 2013, while the tax cuts are permanent.

All this gimmickery is occurring at a time when the Congressional Budget Office (CBO) projects unprecedented deficits. The most recent CBO budget projections make it clear that the deficits are not temporary. Instead, they are structural and will not fade away even if we experience good economic growth. The official projections of $1.4 trillion in deficits over the next 10 years ignore the fact that the deficits would be $3.8 trillion if the Administration had not abandoned its commitment to wall-off the Social Security surpluses. Most private estimators suggest that the deficits will be in the range of $4-5 trillion over the next 10 years. Those projections would be in the range of $6.4-7.4 trillion if Social Security surpluses were walled off.

As a result of the last two years of Republican tax policy, our tax laws are gimmick-ridden. To artificially reduce the official cost of their bills, Republicans have resorted to a vast assortment of gimmicks, such as long phase-ins, temporary provisions, delayed effective dates, and sunsets. As a result, we have a tax law that is extraordinarily unstable. It is difficult to predict exactly what our law will be in the future. Since businesses and other taxpayers cannot make plans on the basis of an unstable tax law, it is doubtful that many of the tax incentives enacted by the Congress will have any real positive effect. The Committee bill makes a bad situation worse.

2. Subsidies for Offshore Operations

The Committee bill provides approximately $40 billion in net tax cuts for the overseas operations of U.S. multinationals. That amount represents approximately two-thirds of the total cost of the bill.

These additional tax benefits for the offshore operations of U.S. multinationals are being considered at a time when the manufacturing sector of our economy is in a crisis of historic proportions. Over the last year, our economy has lost nearly 700,000 manufacturing jobs. Of the 2.7 million jobs the economy has lost during this Bush presidency, 2.5 million of those were in manufacturing. For 38 straight months, the manufacturing sector of our economy has lost jobs, the longest such stretch since the Great Depression.

The Committee bill responds to the loss of domestic manufacturing jobs by expanding tax benefits for the offshore operations of U.S. multinationals. The Committee bill ignores the fact that FSC/ETI, and their predecessor, Domestic International Sales Corporations (DISC), were enacted because our foreign tax rules already were so generous that they operated to disadvantage U.S. producers. The following excerpt from the 1971 House Committee report makes this clear.

> This [i.e., the DISC provision] is important not only because of its stimulative effect but also remove a present disadvantage of U.S. companies engaged in export activities through domestic corporations. Presently, they are treated less favorably than those which manufacture abroad through the use of foreign subsidiary corporations.

Our international tax rules have long been one of our most contentious tax issues. Optimally, our foreign tax rules should be a balance between a desire to ensure that U.S. multinationals are competitive overseas and the desire not to create incentives for U.S. companies to move operations out of the United States. Unfortunately, our rules are sadly out of balance, and they now contribute to the growing flight of manufacturing jobs from the United States.

In 2001, the American Enterprise Institute published an article by two economists (one of whom is a Treasury economist) that analyzed the impact of adopting a territorial tax system in the United States, similar to the system used by some foreign countries. Under a territorial system, the foreign active business earnings of our multinationals would be totally exempt from federal income tax. Surprisingly, the article concluded that providing such a total exemption would increase, not decrease, the U.S. taxes paid by our multinationals. The classic definition of a negative income tax is a tax system which provides greater benefits than a total exemption from tax would provide. Using that definition, there is an overall negative tax on the overseas business operations of U.S. companies.

The surprising conclusion of the 2001 article was validated in 2002 when a group of 32 large U.S. multinationals published a study on whether the U.S. should adopt a territorial system. Those multinationals concluded that "on balance" providing them with a total exemption from tax on their foreign business operations would be unwise. The only logical assumption is that those companies, like the two Treasury economists, concluded that an exemption system would provide fewer benefits than the current tax system provides.

Again, it is worth emphasizing that our export-related tax benefits (currently the FSC/ETI provisions) were enacted by the Congress because our tax laws disadvantage U.S. producers because the rules are much more generous overseas. Currently, there is an overall negative tax on the active business operations of our multinationals. Increasing the size of that negative tax, as proposed by the Committee bill, will simply accelerate the movement of manufacturing jobs out of the United States.

3. Small Net Benefits for U.S. Manufacturers

The main benefit in the Committee bill for U.S. manufacturers is a $61 billion rate adjustment if one assumes that all of that rate reduction really goes to profits from manufacturing actually taking place in the United States. However, the bill also repeals FSC/ETI, a benefit that is almost exclusively enjoyed by U.S. manufacturers. Therefore, the net benefit for U.S. manufacturers in the bill is $18 billion, less than one-third of its $60 billion cost.

The share of the cost enjoyed by U.S. manufacturers shrinks over time. In 2013, U.S. manufactures receive a net tax cut of $2.5 billion, slightly more than 20% of the total net cut provided by the bill.

4. Bill Unlikely to Pass Senate

The Committee bill does not even accomplish the goal of bringing our tax laws into compliance with the WTO ruling. The Senate has made it quite clear that any legislation on this issue will be revenue neutral. Therefore, it is unlikely that the House bill will receive serious consideration in the Senate. Some have suggested that the House is not bound by the Senate views and should exercise its prerogative. Individuals making that argument have also argued strenuously that we must respect the views of the European Union. We would suggest that we should treat the views of the Senate with the same respect that we accord the views of foreign countries. The bill will have to be revenue neutral to pass the United States Senate and, therefore, it is important for the House to develop revenue neutral legislation.

Our opposition to the Committee bill is made easy by the fact that there is a simple, revenue-neutral alternative that could resolve the trade dispute and protect U.S. jobs. Rep. Rangel offered that alternative in Committee. It is based on the Senate Finance Committee bill and would facilitate Senate action. His alternative contains the following elements.

1. The alternative would contain a rate reduction for all U.S. manufacturers, including subchapter S corporations, partnerships and proprietorships. The rate adjustment would be 3.5 points.

2. The alternative would be revenue neutral, using the money from repeal of FSC/ETI, customs user fees extension, and Enron-related tax shelter provisions. This is essentially the approach followed by the Senate Finance Committee. The alternative is structured so that it does not have large, growing out-year costs.

3. The alternative would provide farms, and other small business manufacturers with a permanent tax benefit worth approximately $15 billion over 10 years. The only benefit for non-corporate taxpayers in the Committee bill is a temporary extension of an existing provision. The alternative would also extend that provision.

4. The alternative includes provisions that reward companies for keeping jobs in the United States. It contains none of the provisions from the Committee bill that reward companies for moving jobs offshore.

The Republicans who opposed the Rangel substitute in the Committee voted for a bill that would provide fewer benefits for most taxable corporations operating in the United States and voted for a bill that would provide fewer benefits for all subchapter S corporations, farmers, farm cooperatives, and other unincorporated

U.S. businesses. They voted for a bill that would create a partisan impasse that could threaten trade sanctions. They may wish to reconsider that decision on the Floor.

Following is a chart comparing the Rangel substitute to the Thomas bill.

Factual Comparison of FSC/ETI Rangel Substitute to Thomas Bill		
1. Affect on deficit	Substitute is revenue neutral with no ballooning out-year revenue cost. Substitute is consistent with Bush Administration position that FSC/ETI legislation should be revenue neutral	Thomas bill officially is scored as costing about $60 billion. True cost of bill is far higher. Bill contains long phase ins and temporary tax provisions to hide true costs. Even with those gimmicks, Thomas bill has large ballooning out-year revenue costs, approximately $12 billion per year. Thomas bill is inconsistent with Bush Administration position that FSC/ETI legislation should be revenue neutral.
2. Subsidies for companies that move jobs offshore	Substitute includes no provisions that provide additional tax benefits for companies with offshore business operations. Corporate rate reduction in substitute is structured to reward companies that keep their jobs in the United States	Thomas bill contains an additional $40 billion of tax benefits for the offshore business operations of U.S. multinationals. Bill substantially liberalizes current law rules limiting cross-crediting of foreign taxes, in effect providing tax credits for moving business operations offshore. Thomas bill corporate rate reduction is not designed to reward companies keeping jobs in U.S.

3. Rate reductions for manufacturing activities of taxable corporations	Substitute provides a ten percent across-the-board corporate rate reduction for income from U.S. manufacturing activities. Large corporations receive 3.5 point reduction, from 35% to 31.5%. Smaller corporations receive 3.4 point reduction from 34% to 30.6%. Benefits for large and small corporations are phased in at the same pace. Rate reductions are adjusted to reward companies keeping jobs in U.S. None of the benefits of the rate reductions in Rangel substitute are taken back through imposition of new corporate surtaxes.	Thomas bill provides 3 point rate reduction for large corporations (from 35% to 32%) and a 2 point reduction for small corporations from 34% to 32%. Benefits for large corporations phasein much more rapidly than for small corporations. Rate reductions for large corporations fully take effect in 2007. Rate reductions for small corporations do not fully take effect until 2012. Benefits for small corporations are taken back through imposition of new corporate surtax. Rate reductions are not structured to reward companies for keeping jobs in U.S.
4. Benefits for subchapter S corporations and other non-corporate taxpayers	A. Substitute includes 2-year extension of current law small business expensing benefits. B. Substitute provides 3.5 point rate reduction for shareholders of subchapter S corporations and other non-corporate taxpayers engaged in farming business or in other businesses involving the production of tangible goods.	A. Thomas bill includes 2-year extension of current law small business expensing benefits. B. Thomas bill includes no rate adjustment for subchapter S corporations and other non-corporate taxpayers. The only rate reductions in the Thomas bill are for taxable corporations, with biggest benefit for large corporations.
5. Benefits for farmers	Under substitute, farmers are eligible for a 3.5 point rate reduction, and farmer cooperatives receive benefits consistent with their treatment under ETI.	Thomas bill provides no rate reduction for farmers and no benefits for farm coops other than a small $14 million provision.
6. Repeal of FSC/ETI	Substitute repeals FSC/ETI with binding contract transition rules and 3-year general transition relief. General transition relief structured to be WTO compatible.	Thomas bill provides binding contract relief and three-year general transition. The general transition is not WTO compatible.

7. Special interest provisions	A. <u>Substitute</u> provides benefits only for manufacturers. Service companies are not eligible. B. <u>Substitute</u> contains no miscellaneous tax benefits.	A. <u>Thomas bill</u> provides rate reduction for companies like Halliburton and Bechtel that provide engineering and architectural services. No other service companies are eligible. B. <u>Thomas bill</u> contains numerous miscellaneous tax benefits.

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